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UNCLAS SECTION 01 OF 03 ZAGREB 000337

SIPDIS

SENSITIVE
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DEPT FOR H - PLEASE PASS TO OFFICES OF SENATOR VOINOVICH
AND SENATOR DODD
DEPT FOR EUR/SCE BELL

E.O. 12958: N/A
TAGS: [OREP](#) [PREL](#) [PGOV](#) [HR](#)
SUBJECT: CROATIA SCENE SETTER FOR SENATOR VOINOVICH

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1. (SBU) SUMMARY: Croatia and the government of Prime Minister Ivo Sanader have enjoyed several important successes since your last visit in May 2005. With EU accession negotiations opened on October 4 and Hague indictee Ante Gotovina arrested in Spain on December 7, Croatia has now cleared major political obstacles in its path to Euro-Atlantic integration. What remains are the more difficult agendas of defense and economic reform. The GoC continues to demonstrate leadership in normalizing relations with its neighbors and is actively promoting regional stability. Zagreb advocates clear involvement of Belgrade in determining the final status of Kosovo and is anxious to play a helpful role following Montenegro's upcoming referendum on independence. END SUMMARY.

INTEGRATION: POLITICAL BARRIERS TOPPLED, DEFENSE REFORM UNDERWAY

2. (U) PM Sanader has continued to push Croatia solidly down the path to both the EU and NATO. Croatia cleared a major hurdle with Gotovina's arrest and his transfer to the International Criminal Tribunal for the former Yugoslavia (ICTY) to stand trial on charges of war crimes committed in the aftermath of Croatia's Operation Storm, which liberated the rebel-Serb-occupied Krajina region in 1995. The arrest, applauded by the U.S. and the international community, was not popular domestically, as many Croats consider Gotovina a hero of their war of independence. To its credit, and at some potential political cost, Sanader's Croatian Democratic Union (HDZ) worked to keep the few protests which did occur after the arrest focused on "support for Gotovina" rather than venting anger at the international community or the ICTY.

3. (U) With Gotovina in The Hague, the GOC is focusing on EU negotiations and public promotion of its goal of NATO membership, which is currently supported by less than half of the citizenry. There is a general consensus among the political elite that Croatia belongs in NATO, but the GOC acknowledges that it must do more to generate similar levels of support among the general public.

4. (U) The Ministry of Defense and General Staff are committed to increasing participation in NATO Peacekeeping Operations, and are planning for and funding operations through 2015. Over the summer, the parliament approved tripling to 150 Croatia's troop (currently primarily Military Police) contribution to NATO's ISAF mission in Afghanistan. A Croatian MP platoon is currently in its

seventh rotation in Kabul and the first increase in ISAF contributions will be a seven man Military Liaison and Observation Team to deploy with the Lithuanian PRT in Chagcharan. Currently, Croatia also has 31 persons deployed on 10 UN peace support operations, including Major General Dragutin Repinc, who assumed command on December 29 of the UNMOGIP operation in Kashmir.

¶15. (U) Croatia has an ambitious military reform program in place to make the armed forces "NATO-ready" by 2007 -- a difficult task under the best circumstances thanks to a defense budget burdened by excess personnel and obligatory pension payments to war veterans, leaving only minimal resources for much-needed equipment procurement. We support Croatia's NATO ambitions, but have been very clear in our message that defense reform is an essential pre-condition for Croatia to demonstrate that it will become a net contributor to security through NATO operations. Ambassador Victoria Nuland, the U.S. permanent representative to NATO, echoed this message during a March 7 visit that may be mentioned during your visit.

THE REGION: LEADING THE STABILITY CHARGE

¶16. (U) PM Sanader is very interesting in playing a leading role in promoting regional stability. He continues to promote high-level exchanges and hosted Serbian Prime Minister Vojislav Kostunica in Zagreb in November 2005. The GoC's approach remains one of moderation in the pursuit of fully normalized relations. During that visit, Sanader called for Belgrade's full involvement in determining the final status of Kosovo.

¶17. (SBU) While fully supporting international efforts in the region, Croatia urges caution and full consideration of potential reactions to all proposals. In this context, the

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GoC is willing and anxious to play a helpful role in maintaining stability. It is ready, for instance, to assist however possible following the upcoming referendum on independence in Montenegro.

WAR LEGACIES SLOWLY FADING

¶18. (U) Since your last visit, we have witnessed important events in addressing the legacy of the 1991-95 war. Two major convictions of Croatian defendants in retrials for war crimes against Serbs demonstrated that ethnic bias is disappearing from the courts. International observers such as the OSCE and UNHCR have praised the government's pace of reconstruction of war-damaged housing and return of refugee property, although ethnic discrimination and resistance to change at the local level are persistent challenges.

¶19. (U) Of the estimated 350,000 people, mostly ethnic Serbs, who were displaced during the war, about 134,000 have returned. A UNHCR re-registration project of March 2005 concluded that of the remaining 215,000, mostly now living in Serbia and Montenegro and Bosnia and Herzegovina, the majority have settled in place and do not plan to return. An OSCE/USAID survey indicated that from five to twenty percent of refugees would return if guaranteed employment and housing.

¶10. (U) As suggested by the OSCE, UNHCR, and the European Commission, the Government has created a "road map" with the goal of closing the refugee file in 2006. Elements of this include specific benchmarks such as the resolution of refugee housing, equal access to information and government services, and information on war crimes indictments.

ECONOMY: BETTER THAN NEIGHBORS, BUT ROOM FOR IMPROVEMENT

¶11. (U) Croatia's economy is the most developed of the former Yugoslavia, with the exception of Slovenia. Per capita GDP is approximately \$7,800, more than twice that of neighboring Serbia and Montenegro and roughly equal to Slovakia. Over the last six years, Croatia has enjoyed general macroeconomic stability characterized by low inflation and modest economic growth of approximately 4 percent annually. This growth, however, has been jobless, with the official unemployment rate remaining stubbornly high at approximately 18 percent.

¶12. (U) The state still plays an overly large role in Croatia's economy. Although there has been progress in shedding some of the state's large portfolio of assets, notably banks, hotels and large agricultural combines, the government continues to be saddled with loss-making industrial companies whose subsidies drain approximately 3 percent of GDP annually. As a percentage of GDP, the state's role in the economy is far above the EU average at nearly 40 percent. With one pensioner for every 1.4 persons employed, above-average healthcare costs and out of control entitlement programs, the government faces many necessary, but politically unpopular decisions if it is to reduce chronic deficits and liberalize the country's economy.

¶13. (U) Croatia missed out on the initial rush of foreign investment in Central and Eastern Europe following the fall of the Berlin Wall, largely because of the war in the former Yugoslavia, but also because of its slowness to make the difficult but necessary decisions to reform its economy. Foremost among the factors inhibiting greater investment is an inefficient judicial system that can take years to resolve even the most basic commercial disputes and a stubbornly Byzantine bureaucracy. There has been some improvement in this last area, with the government's creation of a "one-stop shop" for business registration and a trade and investment promotion agency to assist prospective foreign investors, but much more remains to be done.

¶14. (U) Croatia is also saddled by large budget and trade deficits. Although the former has been reduced in recent years partially as a result of an IMF program, the latter has continued to balloon. Foreign debt, particularly in the private sector, has soared as well, now totaling over 80 percent of GDP. The fact that most of this debt is "euro-ized" limits Croatia's ability to let its currency depreciate, a large factor in its uncompetitive exports.

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¶15. (U) Croatia's political elite is fully cognizant of the need to further reform the economy and has made some recent progress in that direction, but much remains to be done to create the conditions to compete successfully in today's global economy. The beginning of EU accession negotiations has added new urgency to this fact.

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